

Publication Date: 07-Sep-2000
Reprinted from RatingsDirect

News

California's GO Bonds Rated 'AA'/ Outstanding GO Debt Rating Raised to 'AA'; Outlook Stable

Analyst: David G Hitchcock, New York (1) 212-438-2022; Steven G Zimmermann, San Francisco (1) 415-371-5004;
Tammy Eng, San Francisco (1) 415-371-5019

NEW YORK (Standard & Poor's CreditWire) Sept. 7, 2000-- Standard & Poor's today assigned its double-'A' rating to California's \$850 million GO bonds dated Sept. 1, 2000, due Sept. 1, 2001-2030. The bonds are scheduled to sell on Sept. 13, 2000.

In addition, Standard & Poor's raised its rating on the state's outstanding GO bonds and GO refunding bonds to double-'A' from double-'A'-minus.

The outlook is stable. The rating upgrade is due to the state's:

- Substantially improved general fund balances,
- New history of conservative fiscal budgeting, and
- Prospect that it will now budget financial reserves on an on-going basis.

Economic growth above fiscal 2000's budget assumptions has allowed the state to advance the timed phase-in of motor vehicle fee tax cuts and increase fiscal year-end total and unreserved general fund balances to a large 11.7% and 8.5% of expenditures, respectively, on a budgetary basis of accounting. For the first time in a number of years, the state has budgeted to retain a significant portion of its reserves. Using conservative economic assumptions, the 2001 budget projects a total general fund ending balance equal to about 3.7% of expenditures and unreserved balances equal to 1.9% of expenditures. While not large, the budgeted reserve represents a large swing from a 7.4% budgetary basis deficit at the end of fiscal 1992, which is equivalent to a 9.2% GAAP basis fund balance deficit. Conservative economic assumptions, the state's strong economic growth, and the use of many onetime expenditure items that need not be repeated in future years have propelled the fiscal turnaround. Nevertheless, California continues to face substantial needs created by growing student enrollments and increased demands for general infrastructure spending.

The following strengths support the double-'A' rating:

- A strong, diversified, and growing economy that has demonstrated resilience in light of weaknesses in Asia, a key export market, which is now benefiting from an economic rebound;
- Two years of positive GAAP general fund balances through fiscal 1999 after many years of deficit fund balances; high budgetary-basis fund balances at fiscal year-end June 30, 2000; and positive projected balances through fiscal 2001;
- Conservative budgeting practices, which, when combined with unexpected economic growth, have led to better-than-budgeted financial results; and
- Debt levels that are expected to remain moderate despite recent and anticipated large increases in bond authorizations.

These strengths, however, are offset by the following considerations:

- Reserve levels that are still relatively small, particularly when measured against the size of the state budget;
- Structural impediments, including state spending allocations, that are

substantially constrained by Proposition 98's funding requirements for schools; and

- The historical lack of midyear budget adjustments or a midyear budget adjustment mechanism when there is a revenue shortfall.

California's diverse economy of 34 million people demonstrated resilience in light of Asian economic weakness. Asia remains a large export market, and California is now benefiting from the Asian economic rebound. State employment grew 2.4% in 1999. Current growth remains strong, particularly in computer-related industries, as well as entertainment, services, and agriculture. Per capita income stabilized at about 104% of the nation's average in 1994 after a long period of relative decline and showed a slight uptick in 1999. Unemployment rates have improved substantially, although remaining higher than the nation at 5.2% in June 2000 versus 4.0% for the nation. GAAP general fund balances rose \$1.8 billion in fiscal 1999 to \$2.3 billion, or 4.4% of expenditures, instead of a budgeted drawdown as revenues rose above expectations. Personal income tax growth, particularly from capital gains, was responsible for much of the state's above-budget revenue increase. Financial gains, however, have also been aided by the state's use of conservative growth assumptions in recent years and the budgeting of substantial onetime capital expenditures, which could be discontinued should capital gains tax revenues fall off.

Fiscal 2001 spending includes \$5 billion of onetime expenditures, not including a \$2 billion reserve for advancement of vehicle license fee tax cuts and a special reserve of \$500 million for potential litigation awards. The 2001 budget makes few major programmatic changes, although it does substantially boost funding for K-12 and higher education. The increase in school expenditures will slightly raise the state-mandated level of future school spending under Proposition 98.

School enrollment growth, Proposition 98 mandates, prison funding required by new mandatory sentencing laws, social service needs, and a two-thirds legislative requirement for budget passage create structural impediments for future budgets, offsetting some of the revenue benefits of economic recovery. Political pressures in the past have made it difficult to maintain fund balances from one year to the next, and the governor's proposal to now keep a 1.9% unreserved general fund balance is an encouraging sign. Proposals have been floated in recent years to allow midyear budget balancing corrections, which is a development that would offset the need for higher fund balances to some degree, although nothing concrete has been enacted. California's net tax-supported debt remains moderate at roughly \$787 per capita. Debt should remain moderate despite the relatively rapid issuance of a recent \$9.2 billion GO bond authorization for schools--under which most of this current bond issue is being sold--and the prospect of the legislature authorizing more bonding for schools in the fall.

OUTLOOK: STABLE

The stable outlook reflects the diversity and strength of California's economy and Standard & Poor's expectation that the state will maintain a slim, but adequate, general fund balance in the future. Factors that weigh against a higher rating include structural budget impediments, such as required supermajority legislative budget approval; Proposition 98's guaranteed levels of education funding; and the political difficulty of funding larger than a 2% budgetary reserve, Standard & Poor's said. -- CreditWire

This report was reproduced from Standard & Poor's RatingsDirect, the premier source of real-time, Web-based credit ratings and research from an organization that has been a leader in objective credit analysis for more than 140 years. To preview this dynamic on-line product, visit our

RatingDirect Web site at www.standardandpoors.com/ratingsdirect.
Standard & Poor's.
Setting The Standard.



Published by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc. Executive offices: Avenue of the Americas, New York, NY 10020. Editorial offices: 55 Water Street, New York, NY 10041. Subscriber services: (1) 212-438-7280. Copyright 2000 by The McGraw-Hill Companies, Inc. Reproduction in whole or in part prohibited except by permission. All rights reserved. Information has been obtained by Standard & Poor's from sources believed to be reliable. However, because of the possibility of human or mechanical error by our sources, Standard & Poor's or others, Standard & Poor's does not guarantee the accuracy, adequacy, or completeness of any information and is not responsible for any errors or omissions or the result obtained from the use of such information. Ratings are statements of opinion, not statements of fact or recommendations to buy, hold, or sell any securities.